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THE ROLE OF FINANCE TOWARDS A MORE SUSTAINABLE DEVELOPMENT

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A STUDY ON REPUTATIONAL RISK MANAGEMENT AT COMMERZBANK AG

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Abstract

This paper examines the idea of the financial sector as a catalyst for a more sustainable development. It discusses the specific role of financial institutions fostering and facilitating more sustainable business practices. In order to understand how financial intermediaries can address sustainability issues in their core business, a comprehensive analysis of the reputational risk management at Commerzbank AG has been conducted. Based on this analysis the paper identifies key elements for sound ESG risk management and introduces recommendations to the processes at Commerzbank. The research is following a qualitative approach based on expert interviews and a comprehensive literature review.

Keywords

Finance and Sustainability, ESG Risk, Commerzbank AG, Sustainable Development

Content

1. Introduction

1.1. Importance of the topic and problem statement

Through their financing function, banks and institutional investors play a central role in the allocation of capital and exercise substantial influence on the entire economic development. Thus it is argued that the financial sector can be seen as a catalyst for the transition towards a more sustainable development (e.g. WWF, 2014). More and more, financial institutions see themselves confronted with ethically questionable businesses, even if they are only indirectly involved. For example, a bank financing the turbines of a German manufacturer for a new water power plant in Brazil, might be held accountable for all environmental issues or human rights aspects (e.g. labour conditions, forced resettlements) caused by the water plant's construction. The underlying idea is that financial institutions mainstream sustainability in their own operations, and thus largely influence the behaviour of the private sector.

There are three main drivers for the financial sector to further contribute to a more sustainable development. First, the required investment for the transition towards a more sustainable economy offers the finance sector an unprecedented opportunity to provide capital and innovative financial products (e.g. Zadek & Robins, 2015). Secondly, it is a matter of addressing risks more adequately. Ensuring that financial services and transactions are conducted in accordance with certain environmental, social and governance (ESG) standards, financial institutions will enhance transparency on their clients' companies and protect themselves from fraud-risks, credit defaults and legal liabilities (e.g. Jaeggi et. at., 2015). Lastly, in times where the role of banks becomes increasingly questionable, valuable positive contributions towards more sustainability will prevent institutions from reputational damage, help to build trust and foster relations between the financial sector and society (WWF, 2014).

However, the potential impact of financial institutions in this context has not been explored in detail yet. Furthermore, it is not clear how to evaluate ESG aspects and further implement them in the processes of financial decision making. Therefore it is necessary to understand the applied processes and mechanisms for ESG risk management in financial institutions today and identify potential improvements for the future.

1.2. Objectives and structure of the paper

This paper is intended to

- discuss the specific role financial institutions play in the transition towards a more sustainable economy,
- evaluate to what extent financial markets have the ability to foster and facilitate more sustainable business practices, and
- understand how the financial sector can implement ESG aspects into financial decision making by analysing one of European's major banks' ESG-risk management process.

A theoretical discussion will introduce the idea of the financial sector as a catalyst for more sustainable business practices. In this context the fundamental concepts of this idea are presented and the underlying potentials and limitations are reflected. The next chapter explains the applied research approach by introducing the research objectives, the applied method and the selection of the case. In the following chapter a comprehensive analysis of the ESG risk management process as part of corporate responsibility efforts at Commerzbank AG is presented.

The research approach consists of expert interviews with specialists in ESG risk and corporate responsibility management at Commerzbank AG, external partners of the bank and, experts from Non-Governmental Organisations (NGOs). In addition a comprehensive literature review of relevant research and publications has been conducted.

2. Theoretical framework - Finance as a catalyst for a more sustainable development

2.1. Role of finance towards more sustainability

The World Commission on Environment and Development (Brundtland Commission) has defined Sustainable Development as a development that "meets the needs of the present without compromising the ability of future generations to meet their own needs" (WCED, 1987).

Originally, the concept had its focus on environmental issues, however the so called "triple bottom line" of sustainability was extended to include social and economic dimensions (Elkington et. al., 2004). With the transition from Millennial Development Goals to Sustainable Development Goals this concept defines the aspirational development for every state, the civil society and the private sector (United Nations, 2015). But considering the status quo, it seems self-evident that more sustainable business practices are urgently needed. On the environmental dimension, the current human ecological footprint exceeds the Earth's capacity to sustain life by 50%, while global resource consumption and carbon dioxide emissions are still growing (WWF et. al., 2010). On the social side, the International Labour Organisation claims that hundreds of millions of people lack the basic labour rights to give them a living that is healthy, save and secure (ILO, 2015). Financial institutions might play an essential role in the transition towards a more sustainable development.

The UNEP FI is a partnership between United Nations Environmental Programme and the global financial sector to recognise the links between financial institutions and ecological, social and governmental issues. They regard financial institutions to be "important contributors to sustainable development", while this includes "their interaction with other economic sectors and consumers" as well as "their own financing, investment and trading activities" (UNEP FI, 2017). On a practical level, achieving a more sustainable development will require huge investments in environmental technology, environmentally sensitive infrastructure and new energy systems. It is estimated that within the next 15 years as much as US$90 trillion will be required to achieve the 2030 Agenda for Sustainable Development and the Paris Agreement (Zadek & Robins, 2016). As it is increasingly recognised that the public sector can only provide for one part of the necessary investment, the finance sector is offered an unprecedented opportunity to provide capital and innovative financial products.

Moreover, the financial sector is amongst the most important contributors of private sector credit. The signals they send their clients about the relationship between - e.g. environmentally or socially sound management practices and credit lending rates - is an important component to have a positive impact on the behaviour of businesses from all sectors (Mansley et. al., 1997). In other words, financial institutions can exercise noticeable influence - sometimes control - over investment and management decisions, so that they are in the position to play a key role in fostering and facilitating more sustainable business practices (Busch et. al., 2015).

According to Waygood (2011) there are basically two principal ways how the financial sector can influence companies in their efforts towards sustainability: financial influence and advocacy influence. The former refers to the fact that the buying and selling of equity shares and debt on the capital market influences the cost of capital for listed companies (Waygood, 2011). Moreover it relates to the practices where financial institutions support more sustainable business practices by financially rewarding environmentally and socially superior behaviour and penalising the bad (Mansley et. al., 1997). Regarding the advocacy influence, there are several ways financial institutions can have an impact on other corporates and it seems to be a topic of increasing corporate relevance. Among others, votes at corporate annual meetings on issues relating to ESG criteria, shareholder proposals, private engagement talks (individually or in a collaborate fashion), media campaigns or file class action lawsuits are ways for the financial institutions to influence other corporates' sustainability efforts (Busch et. al., 2015). But what drives the financial sector to promote more sustainability?

2.2. Key drivers for financial institutions to address sustainability

Considering the reasons for financial institutions to further integrate social, environmental and governmental (ESG) aspects in their business decisions, there has to be made a distinction between regulatory and non-regulatory impacts. Although, many argue that regulators should address ESG issues more systematically (e.g. CISL & UNEP FI, 2014), ESG-related regulation and compliance is a constantly evolving process and a topic of increasing relevance (e. g. WWF, 2014 or Jaeggi et. al., 2016). More and more ESG issues are addressed by international agreements and standards, government policies and regulatory actions such as Basel III, UN Guiding Principles, G20/OECD Principles, SELP in Brazil or Green Credit Guidelines in China. For example, UN and OECD expect private-sector companies to not just focus on the risk for their business during the due diligence process. Thus investors must assess whether or not human rights infringements are linked to their investments. When indicated, they have to address these violations appropriately - regardless of whether or not those investments amount to a business risk (Jaeggi et. al., 2016). Non-compliance may lead to fines and legal risks as well as non-financial sanctions such as losing access to a certain market, so that it becomes mandatory for financial institution to comply with these regulatory requirements (e.g. WWF, 2014).

Besides these increasing regulatory expectations, three main reasons have been identified, why the financial sector should proactively move its core business towards a more ESG driven approach. First and as explained above, the investment needed for eco-friendly technology and infrastructure as well as innovative “green” financial products is an appealing opportunity for the financial sector (e.g. WWF, 2014 or UNEP FI, 2016).

Secondly, there is a chance to reduce banks’ and institutional investors’ risk. Ensuring that financial services and transactions are conducted in accordance with certain ESG standards will enhance transparency on clients’ companies (WWF, 2014). This will lead to a better understanding of risks involved and help protect financial institutions from fraud-risks, credit defaults or legal liabilities. Understanding how well clients address potential ESG issues also helps to develop deeper insights into their business strategy and planning procedures (WWF, 2014). Moreover, financial institutions can also be affected directly by environmental issues or social aspects. In this context it just has to be referred to the massive re-evaluation of assets on fossil fuels (e.g. Baron & Fischer, 2015) and the emerging concerns from the insurance industry in context of climate change (e.g. Koko et. al., 2013).

Lastly, in the current position of the financial market, anticipation and adaptation to the needs of society might also be a matter of competitive survival. The financial crisis has led to an increasing disconnect between the finance sector and society (Anderson, 2015). In this context and with the evolvement of digitalisation and new technologies (Blockchain or Peer-2-Peer financing platforms) the future role of the financial sector is more and more at stake. Making valuable contributions to achieving more sustainability, the financial sector is entitled to refurbish their bad reputation and gain trust. Promoting a positive relationship to society and aligning interests of various stakeholders, financial institutions can legitimatise their existence – asserting their societal given "licence to operate" (WWF, 2014).

2.3. ESG driven decision making in financial institutions

In terms of financial influence, there are several strategies for financial institutions to address sustainability aspects. The following overview introduces some of these strategies.

Table I – Portfolio strategies towards addressing sustainability

Strategies	Description	Examples
Thematic funds and products	Specific sustainability themed investment	Clean tech funds, Green Bonds
Norm-based screening	Addressing specific aspects	Only firms with ISO 14001, FairTrade
Best in class	Only the best performing firms within each industry	Only the 10% best regarding ESG criteria
Exclusion	Applying negative criteria	No weapons, nuclear, or fossil fuels
Integration	Integration of ESG aspects into traditional financial analysis	Research done by in-house departments
Impact investing	Impact comes first (for financial considerations)	Microfinance to help women in India

(Source: Eurosif, 2016).

Each strategy has a different impact and sends different signals to the market. While one could argued that exclusion strategies are very effective as they put a certain pressure on companies, others suggest a far-reaching shared value approaches, where investors seek to incentivise toward addressing sustainability issues proactively in companies' strategies (e.g. Porter & Kramer, 2011). However, all approaches try to reflect on the potential environmental and/or social consequences of financial decisions. In this context the expression of ESG – environmental, social and governmental - is generally used. The following table sums different topics ESG issues can cover.

Table II – Examples for ESG coverage

Environmental	Social	Governance
Climate change, CO2 emissions, biodiversity loss, pollution and contamination, renewable energy…	Human rights violation, labour practices, community resettlement, health and safety, financial inclusion…	Corruption and bribery, reputation, management effectiveness…

(Source: WWF, 2014)

Although sustainable finance is more than sustainable investing, many researchers and practitioners limit their focus solely to asset management. There seems to be great potential in opening up that scope and determining strategies that cover all lines of business. In this context particular attention should be given to banks in relation to their role as financial intermediaries (e.g. Slager & Chapple, 2015). Banks are significant catalysts in promoting economic development. In the same manner, this applies to facilitating a more sustainable development (Busch et. al., 2015). In the following, this paper examines the ESG risk process in Commerzbank AG – one of Europeans major banks.

3. Methodology - Research concept and research objectives

3.1. Selection of the case

To understand the current processes and mechanisms in financial institutions to handle ESG aspects a study on one of the major European bank's ESG-risk management processes has been conducted. Commerzbank AG is the second biggest bank in Germany (by market capitalisation) and one of the major banks in Europe. In this position, the bank finances more than 30 per cent of Germany's foreign trade and is the leader in financing for SMEs in Germany. The analysis of its ESG-risk management process (called reputational risk management at Commerzbank) is intended to understand how a bank of this size and with considerable impact on the German industry implements sustainability aspects into its financial decision making process.

3.2. Research method – Expert interviews

3.2.1. Concept and analysis

The research is following a qualitative approach based on expert interviews and a comprehensive review of accessible relevant material. The applied research method has been chosen to benefit from the advanced knowledge of the experts, who can provide insight to a particular expertise.

The evaluation of the interviews follows the Qualitative Content Analysis approach of Mayring (2014). Therefore, the interviews have been transcribed according to the interview recordings and notes. Afterwards, a preliminary categorisation scheme based on interview guidelines has been developed. With an inductive method, this scheme was supplemented by further subcategories and finally encoded with corresponding QDA software (APPENDIX I).

3.2.2. Content and structure of interviews

The expert interviews were based on half structured guidelines (APPENDIX II). This allows adapting to the specific needs of each conversation, while at the same time it enables structuring the content. Hence, the comparability between the different interviews can be ensured (Meuser & Nagel, 2009). Furthermore, it helps to ensure that not solely aspects that have been anticipated by the interviewee before are taken into account.

The interviews started with an introduction of the expert in order to classify of his/her specific role and to allow the interpretation of the interview in the particular context (Bohnsack et. al., 2010). Afterwards the experts were confronted with different controversial statements in order to discuss the role of the financial sector towards a more sustainable development. In the last part of the interviews, the experts were asked to conduct a critical reflection of the reputational risk management at Commerzbank AG.

3.2.3. Selection of experts

The experts have been selected in accordance to their expertise on the relevant field and their specialised knowledge regarding Commerzbank’s ESG management efforts. Furthermore, different perspectives were included in order to create a more holistic and comprehensive reflection. The following specialists of reputational risk and corporate responsibility management at Commerzbank AG, external partners of the bank and experts from NGOs have been selected for the interviews.

Table III – Selection of experts

ID	Name	Company/ Organisation	Position	Expertise/Perspective
1	Rüdiger Senft	Commerzbank AG	Head of CR	CR Professional in Banking
2	Jana Neumann	Commerzbank AG	Rep-Risk Specialist	ESG-Risk Professional in Banking
3	Hendrik Ohlsen	VfU e.V	Managing Director	Association for Environmental Management and Sustainability in Financial Institutions (DACH Region)
4	Oliver Jaeggi	ECOFACT AG	Managing Director	Research and Consulting in Sustainable Finance
5	Regine Richter	Urgewald e.V.	Consultant & Activist	NGO specialised on Finance

4. Study on Reputational Risk Management at Commerzbank AG

4.1. Introduction to Commerzbank AG

Commerzbank was founded in 1870 as "Commerz- und Diskontobank" by merchants and private bankers in Hamburg. Today Commerzbank is a leading international commercial bank with branches and offices in more than 50 countries, while the core markets of Commerzbank are Germany and Poland. The business is divided into three areas: Private Customers, Mittelstandsbank (SMEs), Corporates & Markets and Central & Eastern Europe. Overall, the bank serves more than 16 million private customers, as well as one million business and corporate clients. In this position, Commerzbank finances more than 30 per cent of Germany’s foreign trade and is the German market leader in financing for SMEs. With approximately 1,050 branches it has one of the largest branch networks among German private banks. In 2015, it generated gross revenues of almost €9.8 billion with approximately 51,300 employees (Commerzbank AR, 2016).

4.2. Corporate Responsibility Management at Commerzbank

Commerzbank (2016) states that corporate responsibility (CR) is a guiding principle of the bank and that "environmental, social and ethical aspects have a crucial role" in the way they manage the company. These aspects are actively managed by the corporate responsibility department, which acts as an interface for all sustainability aspects within Commerzbank Group. It is responsible for internal and external communications regarding sustainability activities, working closely with rating agencies, NGOs and various other stakeholders. Moreover, the CR department reports on sustainability issues to the board management, strategically targets sustainability related topics and coordinates various initiatives and projects connected to sustainability.

To ensure the bank's core business activities are compatible with the bank's understanding of corporate responsibility, Commerzbank tries to include early identification and adequate handling of ESG risks (Commerzbank, 2016). The evaluation of these risks is integral part of the banks overall risk strategy and management, executed by the department of reputational risk management. Once started as one department, CR management and reputational risk management are two different departments today. However, they are working closely together, as the reputational risk assessment is an essential instrument to manage corporate responsibility in the bank's core business.

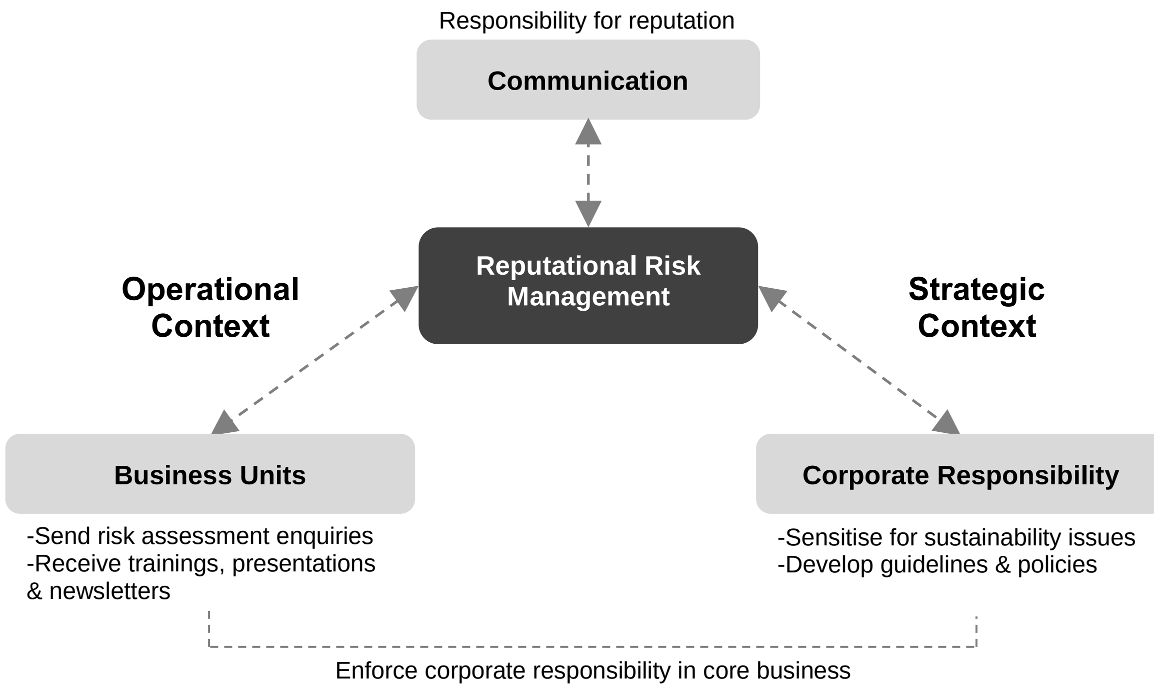
4.3. Reputational Risk Management as part of CR-Management

4.3.1. Organisational set-up

Reputational risk management is a department within the group communications division and is therefore the responsibility of the chairman of the board of managing directors. As mentioned before, it is a central part of the bank's sustainability measures, allowing Commerzbank to include ecological and social aspects next to economic factors in its business assessments (Commerzbank, 2016). In doing so, it is assessing whether or not business opportunities and customer relationships are compatible with the bank’s understanding of corporate responsibility. The evaluation of these ESG risks is integrated in the bank’s overall risk strategy and follows a qualitative approach. Commerzbank defines reputational risk as the risk of its stakeholders losing confidence in the bank or the image being harmed as a result of negative events in the course of its activities (Commerzbank, 2016). The World Economic Forum estimates that on average more than 25% of a company’s market value is directly attributed to its reputation. In banking, where many of the intangible assets are based on client relationships and human resources, whose build-up and maintenance are in themselves substantially influenced by trust and reputation (Eccles et. al., 2007), this might lead to an even more important role. Thus reputational risk has also been addressed by the regulatory activities in BASEL II and BASEL III.

In this context the reputational risk management is exclusively focusing on secondary reputational risks related to transactions in the bank’s core business. While the different legal and compliance departments are verifying legal and regulatory aspects, the reputational risk management is assessing the legitimacy of a business. Different to all the other parts of the risk assessment, the reputational risk management is not part of the business units; it is part of the group’s communication. On the one hand, Commerzbank understands those risks as communicational risks. On the other hand, this organisational structure prevents conflicts of interest in the reputational risk assessment process. The department is able to decide independently regarding the business units’ interests. However, the reputational risk management is working closely with the relationship managers in the business areas. The department relies on the awareness of the account managers to enquire an assessment for projects where ESG aspects are particularly important. The following figure (Figure I) provides an overview on the interdependencies with other departments of Commerzbank.

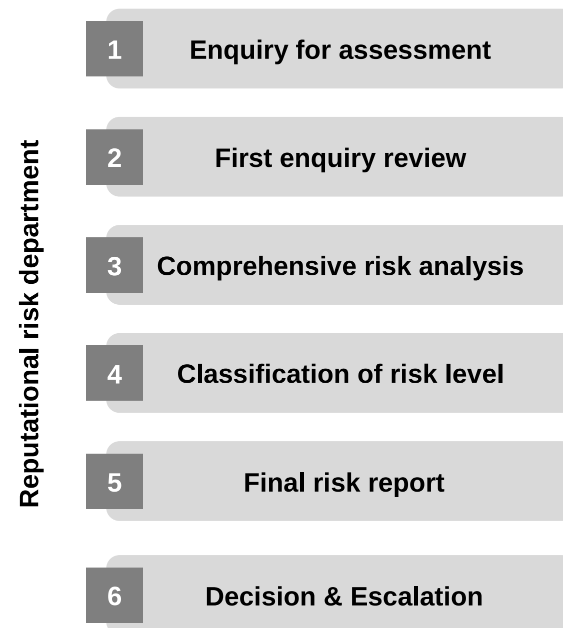
Figure I- Operational and strategic activities of reputational risk department



The figure shows the department's activities in a strategic and operational context. Strategically, the department determines conditions and guidelines for the bank's business activities. Mainly it works on demanding self-imposed standards and official policies on controversial business areas in cooperation with the corporate responsibility department. In an operational context, the department is closely working with the business units and focuses on the assessment of transactions and client relationships, in which sustainability considerations plays a key role. The department that was built around 10 years ago, currently consists of 9 ESG-risk specialists with different expertise and backgrounds in Business, Economics, Politics, Social Anthropology or Cultural Science. In recent years there has been a slight increase in the number of assessments, so that approximately 5.400 reputational risk examinations have been performed in 2015 (Commerzbank GRI, 2015).

4.3.2. Operational process

Figure II- Process of reputational risk assessment



As the figure (Figure II) illustrates, the reputational risk assessment process can be divided in 6 different steps. The process starts with an enquiry of one of Commerzbank's relationship managers (Step 1). Many of these managers work in internationally oriented segments and divisions. As they are looking to make sure that their projects meet the bank's standards, they send an assessment request to the dedicate segment of the reputational risk management department. This department is structured the same as the business units - Mittelstandskunden (SMEs), Private Clients and Corporate & Markets - so that responsibilities are clearly defined. Transactions that deal with pre-defined sensitive topics, such as power plant constructions, mining, pipelines, armaments deals, palm oil, genetic engineering and many others must be presented to the department of reputational risk management (Commerzbank, 2015). As the awareness of the business units is crucial in this process, the reputational risk management conducts several sensitising activities. Step 2 marks the first review of an enquiry, where the department checks, if the envisioned transaction is a relevant for an assessment. In Step 3 the reputational risk management department conducts a comprehensive risk assessment, following a qualitative approach. A team of ESG risk experts examines the different elements of the potential business transaction - the supplier, the end product and the project - asking the following questions (Commerzbank, 2015): Could the potentially poor reputation of a manufacturer rub off on the bank? What kind of reputation does the future operator have as a result of previous projects? Is the product the bank is securing environmentally and ethically justifiable? In practical terms, the experts at reputational risk management identify whether or not an envisioned business transaction seems legitimate and fair. Doing so, the experts at reputational risk management access an ESG risk database from a business intelligence provider specialised in dynamic ESG risk analytics and metrics. In order to insure that additional arguments are not ignored the team at the bank performs further research and cultivates a strong relationship to NGOs as well as other relevant stakeholders. Examining, for example, the construction of a water power plant in Brazil, the ESG risk experts analyse the results of environmental impact assessments, reports on potential human rights violations or the impacts on local communities in terms of resettlement, expropriation and compensation. Moreover, it reviews if there is an involvement of international organisation such as the World Bank or the IFC. When it comes to complex issues more time and resources have to be spent on a request. All enquiries are processed in teams, so that each decision is examined by at least two specialists.

In Step 4, the reputational risk evaluation results in a five-ray classification: no, small, moderate, significant and serious reputational risk. The financial dimension of a business is not taken into consideration as the assessment exclusively focuses on ESG risks. This should ensure an independent extermination. As the risk level has been evaluated, the reputational risk management sends a report with all results to the corresponding inquirer (Step 5). The last step (Step 6) marks the final decision. Eventually, it is the responsibility of the business units, to take the risk of proceeding with a business after they received the results of the reputational risk assessment. However, there are different escalation mechanisms implemented. If a significant reputational risk has been identified, a divisional board member has to be involved to continue with the business. A case of a serious reputational risk may lead to escalation involving the board of managing directors. This can be seen as a certain hurdle; however a high assessment does not automatically lead to a rejection of a business opportunity or client relationship, as long as it does not infringe the binding guidelines and policies. Commerzbank does not provide official data on how many transactions with a significant or a serious reputational risk have been executed. In the conducted interviews, the experts have reported that this number is relatively small.

4.3.3. Discussion and critical review

As most banks do not provide insights into their processes to manage ESG aspects, a comprehensive benchmark analysis it not possible at this point, however a couple of distinctive differences to the approach of other banks can be found. Other institutions, for example, start their ESG risk assessment processes only in case a certain amount of money is attributed to a business. Certainly, banks are not able to conduct ESG-risk examinations with all transaction and client relationships, but making an investigation depending on the financial dimension is falling short to adequately address corporate responsibility issues or prevent reputational damage. It does not matter if a project of €250.000 or €5million is causing violation of human rights or a substantial contamination of the environment. Moreover, and different to several other banks, Commerzbank regards reputational risk management as an own criterion in its risk assessment and thus ensures that ESG risk analysis does not pay off against expected return. The organisational set-up is preventing conflicts of interest with the business units, which is distinctly supportive in this context. This is why Commerzbank's sustainability efforts are often seen as benchmark within the group of international commercial banks. Recently and as the only German bank, Commerzbank was listed in the STOXX® Global ESG Leaders Index. Thus the bank ranks among a group of 300 companies worldwide to distinguish themselves by taking into account ESG criteria in their business activities on a comprehensive scale.

On the other hand, three major aspects in the context of ESG risk assessment have to be reviewed critically. The following will examine on these aspect, however they do not solely apply to the case of Commerzbank.

ESG data quality and metrics: For an adequate assessment of reputational risk involved in a business transaction, the data quality is essential. The reputational risk management at

Commerzbank is using an ESG risk database from a business intelligence provider called RepRisk. The Swiss company is specialised in dynamic ESG risk analytics and metrics. With one of the world's most comprehensive databases on ESG risks, RepRisk provides a web based platform as a due diligence, research, and monitoring tool. Information on ESG risks from publicly accessible sources such as websites, media, reports of NGOs and government agencies in 15 languages are daily analysed and evaluated (Commerzbank, 2015). Their research is driven by 28 ESG issues and covers 45 topic tags, a growing list of ESG "hot topics". Currently its database includes risk profiles for over 60.000 public and private companies, 16.000 projects, as well as for every country (RepRisk, 2016). Even though, ESG data quality has improved extensively during the last years, a lot of the relevant information is not public, so that such a tool does not gain access to it. This might be caused by the fact that a lot of companies are solely founded for the purpose of a big infrastructure project or simply because a case of a negative event never went public. Especially in the light of the discussion on "shrinking space for civil society" it has to be questioned, how to get reliable data on projects in countries where free speech is often being criminalised or media is not able to report independently. Moreover, all data currently used is based on past events. This does not reliably prevent situations causing reputational damage in the future. In addition to this, it has to be reflected on how this data is processed. Commerzbank handles the ESG data in a qualitative approach without using additional decision models or metrics. The applied method can be described as a discursive technique, where a decision is examined by a group of experts - at least two specialists. Like this, the process is highly dependent on individual prospects and attitudes and barley reproducible. Certainly, it is not practical to quantify reputational risk as a numeric unit; however a more formally structured and standardised process to handle the ESG information is recommended. Primarily, this is caused by the non-existence of adequate frameworks and metrics on how to process ESG data. Busch et. al. (2015) comes to the conclusion that the current "practices in using ESG information require significant improvements for data collection processes to result in more reliable and valid outcomes”. They state that without a deeper understanding and trust in ESG data, there won´t be “any confidence in sustainable investments - whether from a purely instrumental or normative perspective” (Busch et. al., 2015). In this context further research and the development of a tool set to support ESG driven business decision is urgently needed.

Cultural integration: The second critical aspect refers to cultural issues. In a very cost driven sector, where maximising shareholder value was the guiding principle for years, it can be a challenge to establish an understanding for social and environmental issues. In this context the name “reputational risk management” and the literal purpose of the department can be seen questionable as well. Does Commerzbank want to prevent reputational damage or is the bank interested to screen its transactions and client relationships because of its understanding of corporate responsibility? And more concrete: Would the bank carry on with controversial business, if nobody paid attention or it is unlikely that those activities go public? Certainly, there are several interdependencies between a bank’s reputation, its ethically reflected attitude and its understanding of corporate responsibility. However, it is important to critically ask for the primary intention to conduct an ESG risk assessment. By naming the department “reputational risk” management, an outsider could argue that the Commerzbank is focusing solely on its image. Even within the bank there are controversial understandings on this. Around 10 years ago, when the bank started to install the reputational risk management process, the assessment primarily focused on image related aspects, although today, the department has become an instrument to manage corporate responsibility in the bank’s core business. Within this period a shift in banking culture can be identified which includes a more holistic approach towards including different stakeholder interests and a deeper awareness for challenges related to sustainability. Today Commerzbank states that it understands its specific role in society and points out that it wants its “core business to influence sustainable development” (Commerzbank, 2016). Therefore an aligned vision of corporate responsibility has to be embedded in the corporate culture. The case clearly demonstrates the importance of employees to understand and internalise this approach. The department of reputational risk management relies on the bank’s account managers to ask for the assessment of projects where ESG aspects are particularly important. This makes the awareness of all staff members dealing with clients in the business units crucial to the process of reputational risk management. Thus sensitising employees has become an important activity for the department. Through trainings and workshops in Germany and abroad, the experts of reputational risk management try to reach out to the banks’ relationship managers. Furthermore, a specialised newsletter and an intranet page regularly inform the managers on current relevant ESG topics and controversial business areas. Currently the department, in cooperation with the corporate responsibility management, is working on a binding digital training for all staff members, same as the in-house compliance training that is obligatory in terms of regulatory requirements. The increased number of annually conducted reputational risk management assessments is likely to primarily result from the increasing sensitisation of employees. However the corporate culture at Commerzbank is undergoing a significant change, the team at reputational risk management is sometimes facing incomprehension. Not everyone in the bank can understand why to reject lucrative business opportunities because of reputational or ethical concerns. This sometimes leads to conflicts with the business units. As mentioned before, although there are a couple of escalation mechanisms in place, in some cases transactions assessed with significant reputational risk, are still carried on. As well when the team at reputational risk management tries to further develop the self-imposed guidelines or adopt official positions, they often face resistance of the business units. Without aligned interests, it is hard for the team to enforce more sustainable practices in the bank’s core business.

Competition dilemma: The last aspect directly refers to the former issue. The dilemma involving competition related aspects is introduced by the question: To what extent is an international bank able to leave out remunerative business opportunities because of increasing ethical interests? Especially in a competitive environment, where other institutions might directly incur the rejected business transaction, the restrictions of the market makes it complicated to enforce a certain level of corporate responsibility. Because of this, many institutions do not use their power to refrain unsustainable business to the full extent and rather focus on securing reputational damage. Certainly, there are to identify significant improvements in the financial sector; however this development appears to be slow in view of the urgency in current sustainability challenges. Especially because of the fact that financial institutions have a crucial rule in the transition towards a more sustainable economy, adequate corporate responsibility should not cause unacceptable drawbacks in competition. In this situation, it seems necessary to search for industry solutions regarding of intersectoral agreements on appropriate ESG standards. As the bank identified a need “to clear up grey areas bilaterally and coordinate the conditions for banking services” (Commerzbank GRI, 2015), Commerzbank actively addresses sustainability issues as part of its membership in several associations (e.g. Bremen Cotton Exchange or the Roundtable on Sustainable Palm Oil). In the conducted interviews all experts highlight the importance of sector initiatives and a cooperative approach between financial institutions to address sustainability issues. In addition to this the relationship to NGOs, regulators and other relevant stakeholders is essential.

4.3.4. Recommendations

To draw a couple of recommendations to the risk management process of Commerzbank AG, a framework for ESG risk management has been developed. The following table introduces the key elements of a sound ESG risk management process intended to foster more sustainable business practices in banking.

Table III – Framework for sound ESG risk management

Key element	Description
Aligned Vision & Strategy	An aligned vision of corporate responsibility has to be incorporated in the corporate culture of an institution. The degree of ESG considerations in corporate vision and mission will depend on a particular bank's business model and its business environment (stakeholder consideration). Each institution has to determine and formalise its ESG ambition level.
Ambitious Policies	ESG policies translate the defined vision of corporate responsibility and the ESG risk ambitions into operational guidelines. Policies on controversial business areas will provide a framework to ensure business activities stay within formulated boundaries and to control the ESG risk profile.
Specialised ESG risk department	Integrating ESG specialists into relevant business lines is important to facilitate sustainable business opportunities. In addition, to asses ESG risks, it is advised to establish a specialised unit correspondent with the size and complexity of an institution. The organisational set up should allow an independent risk assessment and prevent conflicts of interest. Moreover, an institution needs suitably qualified staff as well as the necessary power (e.g. commitment of the board) to enforce standards, guidelines and critical assessments.
ESG Data Supply	Ensuring the reliability and quality of ESG data is crucial for the process of risk management. Banks should watch out for qualified business intelligence providers, specialised in ESG data. Moreover institutions have to establish own data gathering methods using various sources. This should include direct interaction with their clients, as well as with specialised NGOs.
Assessment Methods & Metrics	Processing ESG data require a systematic approach to make results of risk assessments reproducible and decisions comprehensible. Using ESG ratings or dynamic ESG risk exposure algorithms from third parties, institutions have to understand the underlying metrics and methods. Moreover they have to develop their own procedures to asses ESG risk systematically.
Incentives & Control	An appropriate incentive structure to ensure that the performance of measures is aligned with ESG requirements is important. In addition, it is necessary to establish soft hand hard controls to create an enabling environment for sound ESG risk management. Soft controls, relates to sensitisation activities, senior management support as well as adequate training and facilitation of the employees, who are part of the ESG risk management function. Hard controls refer to standardised processes and procedures that can be enhanced by IT-systems.
Stakeholder Engagement	Executing or initiating client engagement activities complement a sound ESG risk management. Working in partnership with their clients to make a positive economic and social contribution in the markets they operate, institutions can maximise their impact for sustainability and actively manage ESG risk. Further engagement with sector and expert stakeholders (e.g. other institutions, NGOs, research institutes) can lead to a better understanding of ESG issues and processes to manage ESG risks. Moreover, institutions can contribute to clear up grey lines in business bilaterally and coordinate the conditions for more sustainable banking services.
Monitoring & Reporting	It is vital to set up monitoring and reporting systems to measure performance and to further improve ESG risk processes. Institutions have to establish performance indicators to monitor progress, to manage and develop the ESG risk strategy and to assess the business impact related to this. Referring to this, GRI Finance Sector Guidelines provide a comprehensive set of useful KPIs.

On the basis of this framework the following will remark a couple of recommendations that will help Commerzbank AG to improve its reputational risk management process. Thus the bank will be able to foster more positive impacts, and reduce the negative effects that might be caused by its business activities.

Develop more reliable measures and methods for ESG data processing: Considering a reasonable resource input and the fact that the team has access to one of the world's most comprehensive ESG databases, the data collection can only be improved insignificantly.

However, the bank’s practices in processing ESG information require a more systematic approach. To make the results of risk assessments reproducible, the bank has to search for more reliable and valid methods and measures. This could be done in cooperation with specialised consulting companies or experts at universities.

Implement control mechanisms in IT-system: Sensitising employees to insure the awareness of relationship managers is an important activity that the department should continue to focus on. In addition, it is recommended to establish control mechanisms in the bank’s IT-system. As the bank is currently rolling out new IT-systems to gather all add data on business transactions and clients relationships internationally, an obligatory question could be implemented verifying whether or not, a transaction is related to a controversial business area. Thus the Commerzbank would be able to ensure that all transactions related to controversial issues are shown to the dedicated reputational risk expert. An IT-based control mechanism could be implemented with manageable resources, while it would effectively ensure the necessary awareness.

Intensify engagement processes: To further strengthen its impact on a more sustainable development, Commerzbank should intensify its engagement activities. Firstly, this applies to its client relationships in order to have a direct impact on their business practices. Secondly, it refers to the banks relationships with other stakeholders to diminish the competition dilemma that was introduced before. So far, Commerzbank just rarely conducts direct conversations with clients on ESG issues or on critical outcomes of assessments from the reputational risk department. Certainly, relationship managers would have to do this in an adequate manner and with certain respect to the particular client, but in a professional partnership it should be possible to reflect on those critical issues. In addition to this, more emphasis could be put on the evolvement of sustainable practices in the entire banking sector. Hence, Commerzbank could diminish the competition dilemma, while helping to develop certain standards that apply to all financial institutions. In cooperation with other banks or insurers, NGOs and other relevant stakeholders, sector initiatives could be introduced and self-imposed industry standard could be established. In a further step, the bank could approach regulators to define more sustainable conditions for banking. Corresponding with the current positioning of Commerzbank this does not mean that the bank has to shift its entire business model towards a "green or ethic bank". The recommendation refers to the already existing understanding of the corporate responsibility at the bank in order to prevent the several detrimental social and environmental business practices that are still not adequately addressed by industry standards and regulatory requirements.

Financially incentivising more sustainable business practices: The idea of giving financial incentives has two dimensions: an internal and an external. Referring to the ideas of a broader stakeholder approach or the current debates on integrated reporting, a more holistic view on performance measuring has been brought into discussion. Commerzbank could partly link the relationships managers' financial compensation to the corporate responsibility performance or their support to mitigate the banks ESG related risks. This might incentivise the managers to reject more businesses with a critical reputational risk assessment and would help to align interest. Moreover, it could contribute to a further cultural integration of corporate responsibility, as it would demonstrate the bank's commitment to sustainability. The external dimension of this idea refers to the practice of further integrating ESG risk into credit conditions. The bank states that it incorporates the ecological and social aspects into credit decisions, but processes and mechanisms in this context are not clear. The bank should follow a more systematic approach. Certainly, it is important, that the reputational risk management tries to verify the legitimacy of a business independently from any financial dimension; likewise, it is important that Commerzbank addresses ESG issues on an adequate financial risk level. A more integrative consideration of ESG aspects in financial risk level would result in certain financial penalties for unsustainable business practices. This would not just allow the bank to more adequately address financial risks; it could also send important signals to their clients and might prompt some companies to strengthen sustainability efforts.

Rethink the label "reputational risk": Renaming the reputational risk management department into "ESG risk management" or "Sustainability risk management" is the last recommendation to be introduced in this paper. This suggestion refers to the cultural shift within the bank since the establishment of the department 10 years ago. As described above, along with an evolving understanding of corporate responsibility, there is to identify a change in the department's function, too – from a solely image-focused risk instrument to an instrument ensuring corporate responsibility in the core business. Regarding the various interdependences in this context, the new name should still incorporate the reputational view (image aspects). However, a re-naming of the department would open the scope towards a more corporate responsibility related assessment and thus send important signals to clients, employees and other relevant stakeholders.

5. Conclusion

Through their financing, investment and trading activities as well as their interaction with other economic sectors, financial institutions exercise substantial influence on the entire economic development (UNEP FI, 2016). Thus they have the ability to foster and facilitate more sustainable business practices, when mainstreaming sustainability in their own operations (Busch et. al., 2015). Especially intermediaries in financial markets with their convening and leveraging power that can influence behaviour of the private sector at large, have an important role in the transition towards a more sustainable economy (WWF, 2014).

Besides increasing regulatory expectations for the consideration of environmental and social aspects (e.g. Jaeggi et. al., 2016 & Berkey, 2016), three main reasons have been identified, as to why the financial sector should proactively address sustainability. First, the required investment for a sustainable transition of the economy provides the financial sector with an unprecedented opportunity to provide capital and innovative financial products. Secondly, further consideration of ESG aspects helps to more adequately assess risks. Lastly, in times where the role of banks becomes increasingly questionable, valuable positive contributions towards more sustainability might help to build trust and reinforce the relation between the financial sector and society. This could help to protect the financial sectors' social licence to operate (WWF, 2014).

The study on Commerzbank's reputational risk management has illustrated how one of Europeans major banks with considerable impact on the German industry tries to implement sustainability aspects into its financial decision making process. The conducted research allowed to understanding the current processes and mechanisms to handle ESG aspects in banking. It showed the organisational set up and critically analysed the different steps in the process of reputational risk management. Compared to other international oriented commercial banks, Commerzbank's approach to address ESG aspects can be describes as relatively advanced; although, three fields have been reviewed critically: the ESG data quality and metrics, the cultural integration and the competition dilemma. In this context, a framework for sound ESG risk management has been established and a couple of recommendations to improve Commerzbank's reputational risk management process were introduced.

In sum, banks and institutional investors can be seen as key drivers or obstacles for a more sustainable development. They can help to ensure that the private sector is better prepared to embark on sustainable business practices, with the introduction of new standards or policies as well as the creation of new products in support of the transition to a "green" economy. From this point of view, an approach towards more sustainability holds great potential to generate positive results for both, the financial sector and the society.

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Appendix

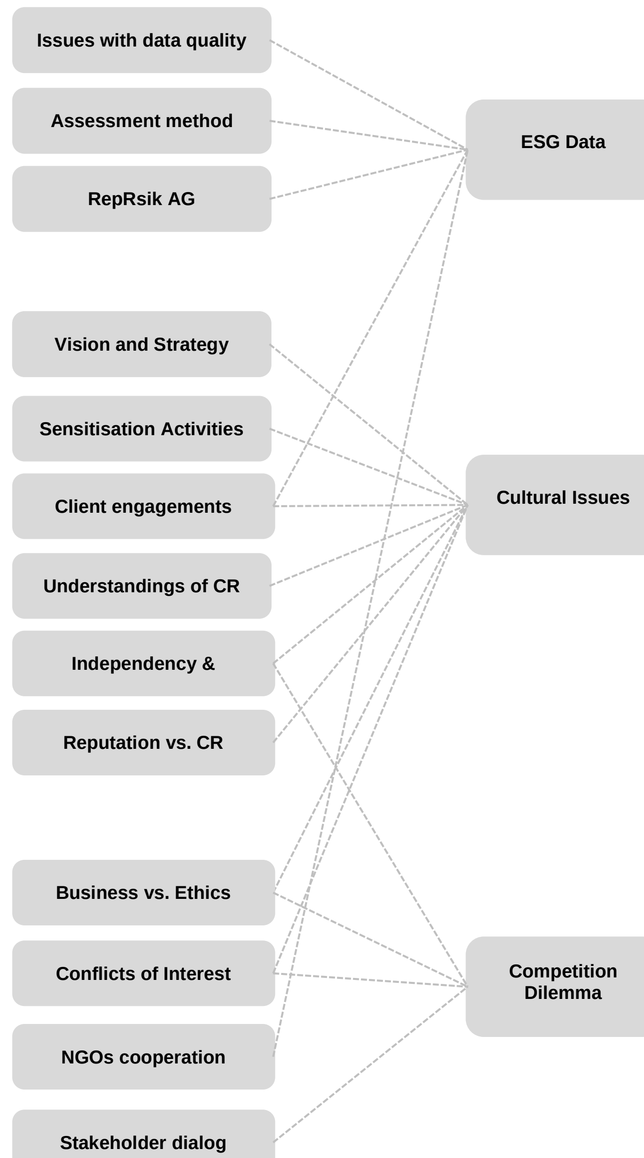
Original interviews and analysis have been conducted in German language. The following provides a translated sample of the QDA-Analysis, showing the applied analysis methodology, and a translated interview guideline, introducing to the interview content.

I. QDA-Analysis

Sample critical review on ESG risk management

Sub Category	N of C	% of C	N of I	% of I
Issues with ESG data quality	12	10%	4	80%
ESG risk assessment method	17	14%	5	100%
RepRisk AG	7	6%	4	80%
Importance of vision & strategy	6	5%	4	80%
Sensitisation activities	12	10%	3	60%
Client engagements	9	7%	3	60%
Understanding of CR	6	5%	2	40%
Independency & commitment	7	6%	4	80%
Reputation vs. CR	8	7%	4	80%
Business vs. Ethics	9	7%	4	80%
Conflicts of interest	13	11%	5	100%
NGO collaboration	7	6%	5	100%
Stakeholder dialog	8	7%	4	80%
	121	100%		

Row 1: main sub categories
Row 2: number of occurrences
Row 3: percentage of all codings on dedicated topic
Row 4: number of interviews where mentioned
Row 5: percentage of all interviews where mentioned



Sample decoding of phrases

Issues with ESD data quality

RR: *…and in this context we faced a problem: how are we going to deal with the topic of "shrinking space for civil society"? Usually, such tools are asking: "Are there protests in a country or not?" But in countries where public protest is criminalised very quickly, of course, this is a problem…*

Conflict of interest considering ESG in decision making

JN: *…it was more like this: "Oh, God, these fellows in the tower, again they coming up with new things destroying my business"…. But I think there has been a rethinking that takes place in the same way as the rethinking in society…*

II. Interview Guideline

Sample: Interview Guideline (translated)
Name of Interviewee (Organisation)

NOVA School of Business & Economics — Shaping powerful minds

Introduction

This interview will be conducted in the course of a work project, presented as part of the requirements for the award of a master's degree in management from the NOVA – School of Business and Economics. The research "The Role of Finance towards a more Sustainable Development", examines the idea of the financial sector as a catalyst for a more sustainable development. It discusses the specific role of financial institutions fostering and facilitating more sustainable business practices. Moreover, the study analysis the reputational risks management of Commerzbank AG as one of European's major banks, to understand practices and management processes to address ESG risk.

I would like to ask you for the permission to record this conversation. Do you agree?

As this work is subject to a confidentiality agreement with Commerzbank, the entire work, including this interview, will not be published.

The interview is divided into three parts:
1. Presentation of the interview partner as an expert in a relevant functional context
2. Reflecting the role of the financial sector for a more sustainable development
3. ESG risk management in the banking sector (example Commerzbank)

Part I: Presentation of the interview partner
I would like to ask you to briefly introduce your role as ….as well as your relationship to sustainability in the financial sector.

Part II: Reflecting the role of the financial sector for a more sustainable development
I would like you to briefly explain to me, to what extent you agree on the following statements:
- Sustainability in the financial industry is becoming increasingly important.
- Banks and institutional investors play a key role in the transition to a sustainable development.
- The financial industry has a responsibility to contribute to a more sustainable development, but no more or less than any other industry, too.

- The potential to contribute to a more sustainable development is not fully exploited by a large part of the financial sector.
- The financial industry is not a suitable driver of sustainability in the market. It should only react to market requirements and adapt to the sustainability movements on the market.

- The social impact should be an independent criterion in financial decision-making processes, alongside the traditional risk and (expected) profit criteria.
- The consideration of ESG criteria is important, but it should only be limited to the risk assessment.

Is there anything you would like to add?

Part III: ESG risk management in the banking sector (example Commerzbank)
In this part of the conversation I would like to address the following questions:
- How can financial institutions take consideration of ESG risks in decision-making processes?

- Do you know the process of reputation risk management at Commerzbank? (If necessary, brief explanation)
- Do you know similar processes in other banks? If so, how does the reputational risk management process in Commerzbank differ from the processes of other banks?

- Where do such processes come to their limits?

- What are the difficulties or challenges associated with the consideration of ESG risks in financial institutions?
- Where do you see improvement potential for processes, which consider ESG aspects in financial decisions?